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Are state-issued bonds for you? It depends on your income

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That, in effect, is the question the State of Rhode Island will ask on Monday when it seeks to borrow \$350 million. The state regularly borrows to help pay expenses, typically by issuing bonds. The state generally uses tax revenue to pay interest and principal to bondholders. But state bonds are out of reach for many investors because the minimum investment is high — typically \$10,000 (it could be less, depending on whom you buy from). However, through a plan created by state

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Video: MoneyLine's Neil Downing talks us through factors to consider when weighing whether to purchase the \$1,000 bonds offered by the state. Watch the video at projo.com

Major market indexes fell to their lowest level in five years yesterday as Wall Street and stock exchanges around the world had a huge selloff on recession fears. The Dow Jones Industrial Average tumbled 312 points. **C1**

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General Treasurer Frank T. Caprio, the minimum investment for Monday's bond offering will generally be only \$1,000.

That means state-issued government bonds will be accessible to more people. So should you invest? It depends. Here's a summary:

■ **What You'll Pay:** You agree, in effect, to lend the state \$1,000 for eight months. The state promises to pay you back \$1,000, plus interest, at the end of the term (June 30, 2009).

The bonds will be issued in the usual way: Financial giants, such as Morgan Stanley, J.P. Morgan and Banc of America Securities, will serve as "underwriters," placing the bonds with various institutions and other big buyers.

However, if you buy through certain branches of Bank of America on Monday (through an investment adviser at the branch who's affiliated with Banc of America Securities), you'll be able to purchase one or more of these bonds for \$1,000 each, Caprio said.

The branches are in Newport, Providence, Barrington, Cranston, Woonsocket and Westerly.

"What we're doing is taking that additional step [to] heighten the awareness of this investment opportunity for Rhode Islanders, because of the rate, and trying to make it ... as user-friendly as possible for Rhode Islanders," Caprio said in an interview at his State House office yesterday.

The lower minimum will broaden the bonds' appeal, said Steve Grasso, chairman of the Rhode Island chapter of the Financial Planning Association, a trade group for financial planners and others. "The minimum investment [will] bring more people to the table to buy," he said.

This is a new bond issue, so if you invest \$1,000, you'll get a bond with a face value of \$1,000, said Tim Gray, a spokesman for Caprio.

You'll pay no commissions on that \$1,000 investment, he said. (But be sure to ask about fees and other such costs before you buy. Some financial institutions charge fees for such things as opening or maintaining an account. Fees can eat into what you earn.)

■ **What You'll Earn:** The annualized interest rate could be around 3 percent, Caprio said. However, the official rate won't be set until Monday morning, he said.

If it is 3 percent, and you invest \$1,000, you'll probably end up earning around \$20 in interest.

That's because the bond matures in eight months, not a year, said Patricia A. Thompson, former president of the Rhode Island Society of Certified Public Accountants.

For a Rhode Island investor, that interest is free from federal and Rhode Island income tax.

■ **Suitability:** Are these bonds for you? It depends on your circumstances.

For example, you've got to have some money to invest. True, the minimum is lower now, just as the minimum for U.S. Treasury securities is lower. But you've still got to come up with the cash.

Also, you must understand a bit about how bonds work, said Grasso, financial adviser for the Cranston branch of the Edward Jones investment firm.

"If you don't understand it, you shouldn't even consider it You should stick to what you know," Grasso said. "It's not for everybody."

If you can afford to invest, and you know how bonds work, keep in mind that a Rhode Island bond is an income-oriented investment, for the conservative end of your portfolio.

It's not about growth or price appreciation; it's about generating some interest income and getting your principal back. (Banc of America Securities representatives will determine an investor's suitability before selling the bonds, Caprio said.)

■ **Safety:** These are general obligation bonds, backed by the full faith and credit of the State of Rhode Island. In other words, they're backed by the state's power to tax. So if you hold a Rhode Island bond until maturity, you'll get your money back.

But if you sell before maturity, you could get back more or less than you originally invested, depending on market conditions at the time of sale.

■ **Taxes:** As a general rule, government bonds are best for people in high income-tax brackets. But that's not always the case.

To see where you'd stand, shop around to learn what similar investments are yielding. Then take a look at your tax bracket. Next, compare how much you'd earn from each after taxes.

Thompson, tax partner and financial planner at Piccerelli Gilstein & Co. LLP, a CPA firm in Providence, offered this example:

Suppose an eight-month CD yields 5 percent and the state bond 3 percent.

Suppose, too, that you're in a combined tax bracket of 45 percent (that's 35 percent at the federal level, 9.9 percent at the Rhode Island level).

In that case, you'd actually earn 2.75 percent on the CD after paying taxes on the interest. But you'd earn the full 3 percent on the state bond, because the state bond's interest is tax-free. So you'd be better off with the state bond.

Now suppose that you're in a combined tax bracket of 18.75 percent (that's 15 percent at the federal level, 3.75 percent at the Rhode Island level).

In that case, you'd actually earn 4.06 percent on the CD, after paying taxes. But you'd earn only 3 percent on the state bond. So you'd be better off with the CD.

■ **Other Options:** At around 3 percent, the state bonds would beat short-term Treasury securities, which lately have yielded around 1 percent or so. But CDs with similar terms are yielding around 4 percent or more, depending on the bank or credit union.

■ **Bottom line:** Caprio's plan is a good idea, because it makes individual Rhode Island bonds accessible to more people, not simply to those with lots of money to invest.

"We're looking forward to very strong participation" in the bond sale by small businesses and individual investors, Caprio said.

But just because the bonds are more accessible doesn't necessarily mean they're for you. Before investing, do some research and decide — with the help of a trusted financial adviser — whether they suit you.

TODAY'S TIP: For more about the bond offering, including a list of participating Banc of America Securities branches, see the state Treasury's Web site:

www.treasury.ri.gov

Or call Banc of America Securities at (401) 278-7306.

The list also includes other brokerages that are selling the bonds. Each such brokerage has its own minimum investment and other requirements.

Questions about your money matters? Call us at 1-401-277-7484 and leave a message, or e-mail:

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Whether you phone in or e-mail your question, please be sure to include your name, hometown and home phone in case we need to reach you. Sorry, no personal replies; as many questions and issues as possible will appear here.